

Thank God It's Friday!

August 10, 2007

In the words of the inimitable philosopher, Yogi Berra: "90% of the game is half mental." This perfectly describes activity this week on Wall Street as traders sold stocks despite solid corporate profits and reasonable stock valuations. They chose to ignore superlative investment fundamentals of high quality performers. Many stocks look cheap to us.

Global financial markets whipsawed investors with a wild ride of volatility, and appeared to be poised to get back on track after July's rout—until a credit squeeze began surfacing. Not surprising, the credit crunch was ignited as more light was shed on the frailty of sub prime loans. Yes, all the cash that has been loaned with reckless abandon not only to American home-buyers with lousy (or zero) credit history, but to the hedge funds and financial institutions that have invented labyrinthine vehicles with which to package and invest in these loans.

The Federal Reserve responded by loaning \$62 billion to credit markets, sending a signal that it will provide the liquidity required to maintain efficiency in the capital markets. This rescue money is the largest the Fed has shelled out since September 14, 2001. Although the stock market seems to appreciate the reassurance, many investors are still worried. Is the Fed signaling that the markets are in serious trouble? We don't think so. The Fed is only doing its job: maintaining liquidity and stability in the financial system.

The global economy is strong. In fact, the International Monetary Fund recently raised their forecast for global economic growth to 5.2%--outstanding growth being shared by nations worldwide. Corporate earnings reports show very solid gains and employment numbers are strong both in the US and abroad. Despite the correction, stock markets are still showing healthy gains year to date.

There will yet be more volatility in these markets. We have known (and written about) the problems in mortgage debt for months. We have positioned our portfolios defensively by underweighting financial stocks, focusing on high quality fixed income, and adding more international securities. Many convoluted financial instruments and sophisticated strategies have been created over the years to profit from the ever-changing market conditions. The last 2 weeks can be viewed as a slap on the wrists of speculation and manipulation. The over-extension of leverage and use of complex quantitative trading strategies has gotten many investors into trouble. The performance over the past two months has proved (again) that a well-diversified portfolio of quality stocks and bonds is still the most transparent and successful vehicle with which to ride through choppy markets. By:

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INDEX	8.10.2007	12.31.2006	%Change
DOW JONES	13,239	12,463	+6%
S&P 500	1453	1,418	+2%
NASDAQ	2545	2,415	+5%
Bond YIELD	4.78%	4.71%	+1%*